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15  
16 UNITED STATES DISTRICT COURT  
17 NORTHERN DISTRICT OF CALIFORNIA  
18

19 IN RE LUMINENT MORTGAGE CAPITAL,  
INC. SECURITIES LITIGATION

20  
21 This Document Relates To:  
22 ALL ACTIONS  
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C 07-04073 PJH

**CLASS ACTION**

**SOUTHERN'S REPLY IN SUPPORT  
OF MOTION FOR APPOINTMENT  
AS LEAD PLAINTIFF AND  
APPROVAL OF ITS SELECTION  
OF LEAD COUNSEL**

Date: November 21, 2007

Time: 9:00 a.m.

Place: Courtroom 3, 17<sup>th</sup> Floor

**PRELIMINARY STATEMENT**

The Southern Improvement Company (“Southern Improvement”), VSA, Inc. (“VSA”), and Allen Dayton (collectively, “Southern” or “Movant”) respectfully submit this reply in support of its motion for appointment as lead plaintiff and for approval of its selection of lead counsel, and in response to the opposition brief of the one remaining competing applicant.

In accordance with this Court’s Order dated October 10, 2007, Southern and five other applicants timely refiled motions for appointment as lead plaintiff on October 17, 2007. Southern filed the certifications required under the Private Securities Law Reform Act of 1995 (“PSLRA”), which included the details of all transactions in Luminent stock and options during the class period, and calculated Southern’s total losses at more than \$1.47 million. *See* Exhibit 1 to Declaration of David C. Harrison in Support of Motion by Southern for Appointment as Lead Plaintiff and Approval of Its Selection of Lead Counsel (“Harrison Decl.”) (Dkt. No. 59).

Southern has by far the largest financial stake in this litigation, which makes it the presumptive lead plaintiff under the PSLRA. *See In re Cavanaugh*, 306 F.3d 726, 730 (9th Cir. 2002) (citing 15 U.S.C. § 78u-4(a)(3)(B)(iii)(i)). Recognizing the futility of challenging Southern’s application, four of the five competing applicants either expressly support or do not oppose Southern’s refiled motion.<sup>1</sup> These movants have implicitly conceded that Southern satisfies the requirements of Fed. R. Civ. P. 23, including the elements of typicality and adequacy.

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<sup>1</sup> The four movants who either support or do not oppose Southern’s application, and their claimed losses, are: (1) District No. 9, International Association of Machinists & Aerospace Workers’ Pension Trust (“District No. 9”) (losses of \$909,163); (2) the State-Boston Retirement System and Norfolk County Retirement System (losses of \$544,409); (3) the Sharenow Group (losses of \$348,452); and (4) Ronald Larsen (losses of \$184,000). *See* Dkt. No. 100, Notice of withdrawal of District No. 9’s motion and support of Southern’s application for lead plaintiff. Two other applicants who initially filed by the statutory deadline of October 9, 2007 withdrew their motions rather than refile on October 17. (Dkt. Nos. 62 and 82.) In total, six of seven competing movants have effectively abandoned their applications to be appointed lead plaintiff.

**ARGUMENT**

**Kornfeld Has Offered No Proof to Rebut the Lead Plaintiff's Presumption**

The one remaining competing applicant is William F. Kornfeld, whose losses are dwarfed by those of Southern. Mr. Kornfeld acknowledges that Southern's losses in Luminent's common stock alone are nearly triple Mr. Kornfeld's losses of \$423,523. William F. Kornfeld, Jr.'s Opposition to Competing Motions for Appointment of Lead Plaintiff and Lead Counsel ("Kornfeld Opp.") at 3. Mr. Kornfeld implicitly concedes that Southern is the presumptive lead plaintiff, and has offered no proof to rebut that presumption by demonstrating that Movant is subject to a unique defense. Accordingly, the Court must appoint Southern as the lead plaintiff.

Mr. Kornfeld's sole argument against Southern's appointment as lead plaintiff is to point to Southern's sale of a modest amount of covered call options as a small hedge against its enormous loss from the purchases of Luminent common stock,<sup>2</sup> and speculate, without any basis, "whether Southern Improvement has engaged in *other* hedging activities which *could* result in its potential disqualification as a class representative." Kornfeld Opp. at 4 (emphasis added). Mr. Kornfeld's counsel further speculates, again without basis, that there are "perhaps more complex hedging activities" which *might* include "buying or selling various market indices" or "selling short other securities deemed to have a value related to that of [Luminent stock]." *Id.* at 3. Mr. Kornfeld does not identify any such indices or other securities, nor explain how such activities would impair Southern's ability to represent the class.

The PSLRA requires "proof" that the presumptively most adequate plaintiff will not adequately protect the class or is subject to a unique defense. 15 U.S.C. § 78u-4(a)(3)(B)(iii)(II). Facts, not baseless conjectures, are necessary to rebut the lead plaintiff presumption. *See, e.g.,*

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<sup>2</sup> A call option is a contract that gives the buyer of the option, in exchange for a premium, the right to purchase the underlying stock at a specific price (the "exercise price") within a specified period. A covered call is a strategy in which an investor sells a call option contract while at the same time owning the underlying stock. "The purpose of engaging in covered call writing is to earn the income from the selling of the call and to provide a hedge against the possible decline of the underlying security." *Grove v. Shearson Loeb Rhoades, Inc.*, No. 80-627-CIV-JE, 1983 WL 1321, at \*1 (S.D. Fla. May 31, 1983).

1 *Armour v. Network Assocs., Inc.*, 171 F. Supp. 2d 1044, 1054 (N.D. Cal. 2001) (Jenkins, J.)  
 2 (citing *Gluck v. CellStar Corp.*, 976 F. Supp. 542, 547-48 (N.D. Tex. 1977)); accord *Montoya v.*  
 3 *Herley Indus., Inc.*, No. 06-2596, 2006 WL 3337485, at \*2 (E.D. Pa. Nov. 14, 2006) (speculation  
 4 will not rebut presumption); *In re Fannie Mae Sec. Litig.*, 355 F. Supp. 2d 261, 263 (D.D.C.  
 5 2005) (opponent's argument "is too speculative and hypothetical to rebut the presumption").

6 Moreover, Mr. Kornfeld's speculation is just wrong. Southern did not engage in any  
 7 investment activities – hedging or otherwise – aside from those disclosed in Southern's  
 8 certifications. See Reply Declaration of Allen Dayton in Support of Motion by Southern for  
 9 Appointment as Lead Plaintiff and Approval of Lead Counsel dated November 7, 2007 ("Dayton  
 10 Reply Decl."), ¶ 3. There is no basis for Mr. Kornfeld's counsel's request to conduct a discovery  
 11 fishing expedition into Southern's trading activity.

#### 12 **Southern's Sale of Covered Call Options Does Not Impact Its Typicality**

13 Mr. Kornfeld acknowledges (Kornfeld Opp. at 4) that another judge of this court, the  
 14 Honorable Susan Illston, rejected the same argument made here by Mr. Kornfeld, *i.e.*, that a  
 15 plaintiff hedging a portion of its common-stock position through the sale of call options is  
 16 subject to unique defenses. See *Crossen v. CV Therapeutics*, No. C 03-03709 SI, 2005 WL  
 17 1910928 (N.D. Cal. Aug. 10, 2005). The *Crossen* court explained that the fact that plaintiff  
 18 hedged his investment will not defeat the presumption of reliance, as long as he made ordinary  
 19 purchases of common stock and sustained losses on those holdings.<sup>3</sup>

20 Numerous other courts have likewise held that the use of hedging and other investment  
 21 strategies does not render a class plaintiff atypical or subject to a unique defense. See, *e.g.*,  
 22 *Montoya*, 2006 WL 3337485, at \*1 (presumptive lead plaintiff appointed – "an investor who

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23 <sup>3</sup> This Court recently confirmed that the typicality requirement of Rule 23 does not  
 24 require that the circumstances regarding the representative party's purchases be identical to those  
 25 of the other class members. Rather, the typicality requirement of Rule 23 is satisfied where, as  
 26 here, the claims arise from the same course of conduct (*e.g.*, the purchase of stock at inflated  
 27 prices) and are based upon the same legal theory (*e.g.*, violations of federal securities law). See  
 28 *In re Dynamic Random Access Memory (DRAM) Antitrust Litig.*, M 02-1486 PJH, 2006 WL  
 1530166, at \*4 (N.D. Cal. June 5, 2006) (Hamilton, J.).

engaged in short sales to hedge against a decline in its investment may benefit from the fraud on the market presumption [and is] not vulnerable to a unique defense”); *Levie v. Sears Roebuck & Co.*, 496 F. Supp. 2d 944, 950 (N.D. Ill. 2007) (class certification granted: “The fact that Monsky may have devised a different investment strategy as a consequence of his reliance on the market is irrelevant. If he relied on the price of Sears stock to reflect accurately information disseminated in the market, he was injured if defendants made fraudulent misrepresentations and omissions of material fact.”) (citation omitted); *Chill v. Green Tree Fin. Corp.*, 181 F.R.D. 398, 412 (D. Minn. 1998) (presumptive lead plaintiff appointed – “one who buys Green Tree stock, even as a hedge against other investments, still presumably relies on the integrity of the market in selecting that hedge” absent evidence to the contrary); *Danis v. USN Communs., Inc.*, 189 F.R.D. 391, 397 (N.D. Ill. 1999) (class certification granted – “The fact that Kerr may have used somewhat distinctive buying strategies does not render him atypical with respect to this claim of overarching fraud.”) (citation omitted).<sup>4</sup>

The reasoning of *Crossen* and these other authorities is fully applicable here. Southern stood to gain financially from its purchase of 160,000 shares of Luminent stock. Its sale of call options – which still left 80 percent of Southern’s position unhedged – modestly reduced the loss it suffered following Luminent’s announcement on August 6, 2007 that its liquidity, which management had touted one week earlier as “ample” when confirming the safety of the dividend, had disappeared virtually overnight. Southern lost more than \$1.2 million on its Luminent common stock and another \$213,000 from the sale of put options. The gain from call options sales was \$13,047. See Loss Calculations, Exhibit 1 to Harrison Decl. As in *Crossen*,

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<sup>4</sup> Mr. Kornfeld’s authorities are inapposite. In *Hamilton Ptnrs. Ltd. v. Sunbeam Corp.*, No. 99-cv-8275, 2001 WL 34556527, at \*\*10-11 (S.D. Fla. July 3, 2001), plaintiff failed to establish an efficient market in connection with the private placement of convertible debentures, precluding utilization of the fraud-on-the-market presumption of reliance. *Sherin v. Gould*, 115 F.R.D. 171 (E.D. Pa. 1987), involved a *stipulated* class which excluded stock purchasers involved in program trading activity involving stock market index futures. Here, Southern engaged in no such activity with respect to Luminent securities. See Dayton Reply Decl., ¶ 3.

1 Southern's "investment strategy does not make [it] an atypical plaintiff." *Crossen*, 2005 WL  
2 1910928, at \*5.

3 **Kornfeld's Request For Additional Discovery Is Without Merit**

4 Seizing upon Judge Illston's comment in *Crossen* that a call option hedge "on its own" is  
5 insufficient to defeat typicality, 2005 WL 1910928, at \*4, Mr. Kornfeld asks for discovery in a  
6 desperate effort to find something more. However, under the PSLRA, the movant requesting  
7 discovery must first "demonstrate[ ] a reasonable basis for a finding that the presumptively most  
8 adequate plaintiff is incapable of adequately representing the class." *Cavanaugh*, 306 F.3d at  
9 730 (citing 15 U.S.C. § 78u-4(3)(B)(iv)). Mr. Kornfeld's unfounded innuendos are wholly  
10 insufficient to merit discovery. *See, e.g., Carson v. Clarent Corp.*, No. C 01-03361 CRB, 2001  
11 WL 1782712, at \*2 (N.D. Cal. Dec. 14, 2001) (denying request for discovery in connection with  
12 appointment of lead plaintiff) (Breyer, J.); *Knisley v. Network Assocs., Inc.*, 77 F. Supp. 2d 1111,  
13 1115 (N.D. Cal. 1999) (Armstrong, J.) (same).<sup>5</sup> Mr. Kornfeld's request for discovery should be  
14 denied.<sup>6</sup>

15  
16 **CONCLUSION**

17 For the foregoing reasons, Southern's application for lead plaintiff should be granted, and  
18 its selection of Lowey Dannenberg Bemporad Selinger & Cohen, P.C. as lead counsel should be  
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20 <sup>5</sup> Mr. Dayton's declaration disposes of Mr. Kornfeld's speculation (Kornfeld Opp.  
21 at 4 n.4) that Mr. Dayton's deposition transcript, taken in an unrelated commercial lawsuit VSA  
22 filed against its supplier, might shed light on Mr. Dayton's hedging transactions relating to  
Luminent.

23 <sup>6</sup> The single case cited by Mr. Kornfeld in support of his discovery request, *Brown*  
24 *v. Biogen IDEC, Inc.*, No. 05-10400-RCL, 2005 U.S. Dist. LEXIS 19350, at \*3 (D. Mass Jul. 26,  
25 2005), is inapposite. In *Biogen*, limited discovery was ordered from a proposed lead plaintiff  
26 who had failed to provide any information regarding its transactions or the computation of its  
27 claimed losses. *Id.* There was also a question regarding whether the proposed lead plaintiff was  
an improper group of unrelated individuals. *Id.* Therefore, discovery was necessary to identify  
the presumptive lead plaintiff with the largest loss – not just to evaluate whether that plaintiff  
satisfied the requirements of Rule 23. *Id.* Here, Southern's submissions detail its transactions,  
losses, and satisfaction of the requirements of Fed. R. Civ. P. 23.

1 approved. Mr. Kornfeld's motion for lead plaintiff and his request for discovery should be  
2 denied.

3 Date: November 7, 2007

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